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IN THE

Supreme Court of the United States

October Term, A. D., 1940.

SOUTHWESTERN HOTEL COMPANY,
Petitioner,

versus

UNITED STATES OF AMERICA,
Respondent.

PETITION AND BRIEF FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE UNITED STATES.

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To The Supreme Court of the United States:

Your Petitioner, Southwestern Hotel Company, respectfully requests this Court to review by Writ of Certiorari a judgment of the United States Circuit Court of Appeals for the Fifth Circuit, in which that Court affirmed a decree of the District Court for the El Paso Division of the Western District of Texas.

In the trial court, Southwestern Hotel Company sought to recover from the United States $989.24, with interest from March 10, 1939, at 6% per annum. It alleged that the ninety-nine year lease under which it occupied the Hilton Hotel in El Paso, Texas, required it, as the Lessee, to pay, *as a part of the rent,* the sum of $18,000.00 accruing in the fiscal year ending August 31,

1935, on the principal of a mortgage on the Hilton Hotel, and that it had deducted this $18,000.00 *paid as rent* from its gross income for that fiscal year. It alleged that it had been required by the Collector of Internal Revenue to pay an additional income and excess profits tax of $989.24, on the idea that the proper deduction should have been $12,720.00 instead of 18,000.00, based on the theory that the principal of the mortgage, $424,000.00, should have been prorated over the presumed life of the Hilton Hotel building, 33-1/3 years. It alleged that a proper claim for refund had been filed, upon which no action had been taken for more than six months. It sought to recover the illegal tax from the United States.

The Trial Court held that the contention of the Commissioner of Internal Revenue was correct, and denied a recovery. On appeal to the United States Circuit Court of Appeals for the Fifth Circuit, that Judgment was affirmed, on the theory that while the principal of the $424,000.00 mortgage should not have been prorated over the 33-1/3 year life of the building, it should have been prorated over the ninety-nine year term of the lease, and since that would have resulted in a larger tax than the tax actually paid, Southwestern Hotel Company could not complain, and the judgment of the Trial Court should therefore be affirmed.

A. SUMMARY STATEMENT OF THE MATTERS INVOLVED.

1. The lease between Albert Mathias and wife, as Lessors, and Southwestern Hotel Company, as Lessee, provides in Article II for cash monthly rentals, in fixed amounts, during the period from September 1, 1933, to August 31, 1950. It provides that after August 31, 1950, there shall be substituted for these fixed monthly rentals

a monthly rental which would yield a net annual return of 6% on the then ground value of the Mathias property. The lease also provides that as "Additional Money Rentals" the Lessee should pay the sums due and to become due on the Pacific Mutual Life Insurance Company mortgage, upon which there remained, after September 1, 1933, a balance of $424,000.00, maturing in fixed amounts each year for a period of years. It is further provided in the lease that the Lessee shall be required to reduce the principal amount of the mortgage not less than $12,000.00 a year during the first three years of the lease and not less than $20,000.00 a year during the succeeding years of the lease. It also provides that the Lessor should be required to join with the Lessee in refinancing agreement so as to extend and renew the indebtedness secured by the mortgage from time to time to permit payments on the principal of not less than $20,000.00 a year after the first three years. Section 2 of Article III of the lease provides a way for assistance to the Lessee to prevent it from being required to pay more than $12,000.00 a year during the first three years of the lease. Can the Lessee, under such a lease, deduct for the fiscal year ending August 31, 1935, as a part of its rental expense, the sum of $18,000.00, the actual amount payable during that year on the principal of the mortgage, or can he only deduct $4283.00, an amount equal to $424,000.00 divided by ninety-nine, the number of years that the lease had to run, as held by the United States Circuit Court of Appeals?

2. Under the lease such as is referred to in the preceding question, can the Lessee deduct for the fiscal year ending August 31, 1935, as a part of his rental expense, the sum of $18,000.00, the actual amount payable during that year, or can he only deduct $12,720.00, an amount

equal to $424,000.00 divided by thirty-three and one-third, the number of years which the building on the leased premises will be presumed to last, as held by the Trial Court?

We shall state sufficient of the pleadings and of the evidence to show that the above questions are involved in the decision of this case.

Pleadings.

Plaintiff's Original Petition, filed October 25, 1939, (R. 2 to 14).

1. In due time, Plaintiff filed its income tax return for its fiscal year September 1, 1934, to August 31, 1935, showing a deduction of $27,500.00 on account of payments made during such fiscal year to The Pacific Mutual Life Insurance Company of California on the principal of its mortgage on the Hilton Hotel property, and paid the income tax so arrived at. The deduction was taken because the payment was due as a part of the rents payable under Plaintiff's lease on the Hilton Hotel property. The Internal Revenue Agent objected to the deduction of $27,500.00 on the ground that only $18,000.00 actually accrued and became due on the mortgage during the period in question, the Lessee having paid $9500.00 more than it was actually required to pay during such fiscal year. Plaintiff acquiesced in the ruling, and paid the additional tax requested (R. 2).

2. Thereafter, the Commissioner of Internal Revenue ruled that while $18,000.00 became due and payable under the lease and mortgage for the fiscal year, said payment should not be considered as deductible for that year. The ruling was to the effect that the principal

amount of the mortgage should be spread over the life of the Hilton Hotel Building, which was fixed at 33-1/3 years. So allocated, the annual allowable deduction was fixed at $12,720.00, and the net income for the year was increased by the difference between $18,000.00 and $12,-720.00, or $5280.00. This resulted in a deficiency assessment of $989.24 (R. 2, 3).

3. The Collector demanded payment of $989.24, with interest to March 10, 1939, at 6% per annum, making a total of $1185.27. Payment was made in accordance with this demand, and said sum has heretofore been retained by the United States (R. 3, 4).

4. On March 28, 1939, Plaintiff duly filed a claim for refund, claiming that the full $18,000.00 was a deductible expense for the fiscal year 1934-1935. The claim was received by the Collector on March 31, 1939. For more than six months after the receipt of the claim, the United States, its Commissioner of Internal Revenue, and its Collector of Internal Revenue, at Austin, Texas, failed to act on said claim (R. 3-7).

5. Payment of $18,000.00 was made by Plaintiff in accordance with the terms of a lease for a period of ninety-nine years, beginning September 1, 1933, and ending the 31st of August, 2032, containing provisions customarily found in a long term lease of that character, including certain provisions with reference to the payment of cash monthly rentals and the payment of taxes and insurance, and a further provision requiring the Lessee to pay as "Additional Money Rentals" the amounts accruing annually on the principal of a note secured by mortgage against the Hilton Hotel property, held by The Pacific Mutual Life Insurance Company of California, it being provided that the Lessee should, during the first three years of the lease, pay at least $12,000.00 a year

upon the principal and should thereafter pay at least $20,000.00 a year on the principal of said indebtedness. By the express terms of the lease, the payments to The Pacific Mutual Life Insurance Company of California were made a part of the money rentals to be paid by the Lessee, and in the event of a termination of the lease the liability of the Lessee to continue to make payments on said mortgage would have terminated in the same manner as the liability of the Lessee for the payment of monthly rentals (R. 8-16).

6. The unpaid balance on the note held by The Pacific Mutual Life Insurance Company of California on September 1, 1933, was $425,000.00, of which $1000.00 was paid on September 1, 1933. The $424,000.00 balance on said note was, by the agreement of the parties interested in said obligation, payable over a period of years, and by said agreements there became due and payable on said indebtedness during the fiscal year which ended August 31, 1935, the sum of $18,000.00, and by virtue of Article III of the above mentioned lease the Lessee in said lease was compelled to pay as additional monthly rentals for said fiscal year the total sum of $18,000.00, and said sum actually accrued for said fiscal year as a part of the rents payable under said lease, and said sum was actually paid during said twelve months' period. The payment of the $18,000.00 was properly chargeable as rents and expenses of the Plaintiff for said fiscal year, and should have been so allowed in the calculation of the income tax and excess profits tax payable by the Plaintiff to the United States for said fiscal year (R. 16-17).

7. All income taxes, excess profits taxes and all other sums of every kind due and payable by the Plaintiff to the United States upon all accounts have been

paid, and there are no sums now due and payable from this Plaintiff to the United States, and Plaintiff is entitled to recover from the United States the sum of $989.-24, with 6% interest per annum from the 15th of November, 1935 (R. 17).

Plaintiff prayed for the recovery of $989.24, interest and costs (R. 17).

Defendant's First Amended Original Answer, filed February 19, 1940 (R. 19-21).

The United States, in its Amended Answer, admitted substantially all of the allegations of fact contained in Plaintiff's Original Petition, but alleged that the $18,-000.00 referred to in Plaintiff's Petition was paid by the Plaintiff on the mortgage described in Plaintiff's Petition as a part of the consideration for the use of the property for years other than the taxable year, and that only the part thereof properly attributable to the process of earning income during the taxable year in question was deductible from Complainant's gross income for such year; that the amount so attributable was $12,720.00, and that this was the only amount that could be deducted as an expense during said taxable year, and that the sum of $5280.00 out of said $18,000.00 payment was properly disallowed as an expense for said year.

Evidence.

Testimony of E. H. Krohn (R. 42-54).

This is the original lease which was made by Albert Mathias as lessor and Hilton Hotels, Inc., as lessee, on October 9, 1929. It was dated as of September 1, 1929, and was signed October 9, 1929 (R. 42-43). (*This is not the lease directly involved here.*)

This is a supplement to that original lease. This instrument slightly modified the description of the property, and recited that the lessor and the lessee were executing a deed of trust on the real estate covered by the lease to secure a note signed by the lessee, for the purpose of providing funds with which to partially pay for the cost of erecting improvements upon the real estate, and the lessee covenanted and agreed to pay the payments accruing on said note, and that in the event it should default in making such payments the lessor might terminate the lease. The instrument provided for certain liens in favor of the lessor to secure performance by the lessee, and was dated February 21, 1930 (R. 43).

This is a certified copy of the deed of trust of The Pacific Mutual Life Insurance Company of California. This Deed of Trust was executed by Albert Mathias and Frieda Mathias, covering the Hilton Hotel property, which was conveyed to two trustees to be held in accordance with the terms of the deed of trust. It recited that it was given to secure the payment of a note dated February 28, 1930, in the principal amount of $450,000.00, bearing interest from date at the rate of 6% per annum, payable May 1, 1930, and quarterly thereafter. The principal amount of the note was payable as follows:

$2500.00 on August 1st and November 1, 1931, and on February 1st and May 1, 1932;
$4500.00 on August 1st and November 1, 1932, and on February 1st and May 1, 1933;
$5000.00 on August 1st and November 1, 1933, and on February 1st and May 1, 1934;
$5000.00 on August 1st and November 1, 1934, and on February 1st and May 1, 1935;
$5500.00 on August 1st and November 1, 1935, and on February 1st and May 1, 1936;
$6000.00 on August 1st and November 1, 1936, and on February 1st and May 1, 1937;

$6000.00 on August 1st and November 1, 1937, and on February 1st and May 1, 1938;
$6500.00 on August 1st and November 1, 1938, and on February 1st and May 1, 1939;
$7000.00 on August 1st and November 1, 1939, and on February 1, 1940; and
$265,000.00 on May 1, 1940.

The deed of trust had the usual provisions with reference to acceleration of maturity in event of default, and with reference to sale of the property by the trustees. The other provisions are not material here (R. 43-44).

The Hilton Hotel property, since 1934, has been and is now owned as follows: one-fifth (1/5) by Albert Mathias and wife, and four-fifths (4/5) by Mathias Trust Estate (R. 44-45).

A printed copy of *the present lease* was introduced. This lease was executed by Albert Mathias and Frieda Mathias as Lessors and Southwestern Hotel Company as Lessee, as of September 1, 1933, and ran for a period of ninety-nine years, beginning September 1, 1933, and ending August 31, 2032. The lease covered the Hilton Hotel property. The lease contained the provisions as described in Paragraph VIII in Plaintiff's Petition in this suit (R. 45). (*This is the lease directly involved here.*)

Court's Findings of Fact and Conclusions of Law and Judgment (R. 22-28 and R. 37-38).

The Trial Judge found the facts to have been substantially as pleaded by Plaintiff. He concluded that the law was with the Defendant, holding that Plaintiff could not deduct the $18,000.00 which it was required to pay as rent during the fiscal year on the principal amount of the mortgage of The Pacific Mutual Life Insurance Company, but that it could only deduct 1/33-1/3 part of

the $424,000.00 principal amount of the mortgage. In other words, the Court held that the $424,000.00 principal amount of the mortgage should be divided by 33-1/3, the number of years which the present Hilton Hotel building would be presumed to exist, and the resulting figure, $12,720.00, was the amount deductible during each of the 33-1/3 years, beginning with the inception of the lease.

Plaintiff was denied any recovery.

B. REASON RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

The lease between Albert Mathias and wife as Lessors and Southwestern Hotel Company as Lessee, provides in Article II for cash monthly rentals in fixed amounts during the period from September 1, 1933, to August 31, 1950. It provides that after August 31, 1950, there should be substituted for these fixed monthly rentals a monthly rental which would yield a net annual return of 6% on the then ground value of the Mathias property. The lease also provided that as "Additional Money Rentals" the Lessee should pay the sums due and to become due on the Pacific Mutual Life Insurance Company mortgage, upon which there remained, after September 1, 1933, a balance of $424,000.00, maturing in fixed amounts each year for a period of years. It is further provided in the lease that the Lessee shall be required to reduce the principal amount of the mortgage not less than $12,000.00 a year during the first three years of the lease and not less than $20,000.00 a year during the succeeding years of the lease. It also provides that the Lessor should be required to join with the Lessee in refinancing agreements so as to extend and renew the indebtedness secured by the mortgage from time to time to

permit payments on the principal of not less than $20,000.00 a year, after the first three years. Section 2 of Article III of the lease provides a way for assistance to the Lessee to prevent it from being required to pay more than $12,000.00 a year during the first three years of the lease. The Circuit Court of Appeals held that the Lessee could not deduct for the fiscal year ending August 31, 1935, as a part of its rental expense the sum of $18,000.00, the actual amount payable during that year as rent, but could only deduct $4283.00, an amount equal to $424,000.00 divided by ninety-nine, the number of years that the lease had to run, and that therefore the Judgment of the lower court in permitting a deduction of $12,720.00, an amount equal to $424,000.00 divided by 33-1/3, the number of years which the building on the leased premises would be presumed to last, should be affirmed.

THE CIRCUIT COURT OF APPEALS, IN MAKING SAID DECISION, HAS ERRONEOUSLY DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW, WHICH HAS NOT BEEN, BUT WHICH SHOULD BE, SETTLED BY THE SUPREME COURT.

PRAYER FOR WRIT.

Wherefore, your Petitioner prays that the writ of certiorari be issued out of and under the seal of this Court, directed to the Circuit Court of Appeals for the Fifth Circuit, commanding that Court to certify and send to the Supreme Court a full and complete transcript of the record, and of all the proceedings in the case numbered and entitled on its docket, "No. 9556, Southwestern Hotel Company, Appellant, versus United States of America, Appellee", to the end that this case may be reviewed and determined by this Honorable Court, as pro-

vided by the statutes of the United States, and that the Judgment of the Circuit Court of Appeals for the Fifth Circuit be reviewed and reversed, and for such other relief as may seem proper to this Court.

DATED at El Paso, Texas, this 31st day of January, 1941.

Respectfully submitted,

SOUTHWESTERN HOTEL COMPANY,
Petitioner,

By:

THORNTON HARDIE,
Of El Paso, Texas,

Attorney for Petitioner.